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No. 86-44

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

SHEARSON/AMERICAN EXPRESS INC. and
MARY ANN MCNULTY,

Petitioners,

v.

EUGENE MCMAHON, JULIA MCMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF OF PETITIONERS

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QUESTIONS PRESENTED

1. Whether the United States Arbitration Act, 9 U.S.C. § 1 *et seq.* (1982), mandates arbitration of claims asserted under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* (1982) pursuant to a valid arbitration agreement?

2. Whether the United States Arbitration Act, 9 U.S.C. § 1 *et seq.* (1982), mandates arbitration of claims asserted under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961 *et seq.* (1982) pursuant to a valid arbitration agreement?

RULE 28.1 LIST*

Non-Wholly Owned Subsidiaries and Affiliates of Shearson Lehman Brothers Inc.

Active Subsidiaries

Shearson Lehman/Amex Finanz A.G.
Shearson/NGP Inc.

Affiliates

Banque Eurofin
Barony Company Ltd.
Carnegie Capital Management Company
Russell Energy Inc.

Non-Wholly Owned Subsidiaries and Affiliates of Shearson Lehman Brothers Holdings Inc., the parent company of Shearson Lehman Brothers Inc.**

Dr. Pepper Holding Company
Shearson Lehman Brothers Limited
The McLeod Young Weir Corporation

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* This list supplements the Rule 28.1 List contained in the Petition for a Writ of Certiorari.

** The parent company of Shearson Lehman Brothers Holdings Inc. is the American Express Company.

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MARY ANN MCNULTY,

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v.

EUGENE MCMAHON, JULIA MCMAHON, individually and as trustees of THE DAVID J. HODDER & SON, INC. EMPLOYEE PENSION PLAN; THE DAVID J. HODDER & SON, INC. PROFIT SHARING PLAN; THE LAURIE FUNERAL HOME, INC. EMPLOYEE PENSION PLAN; and THE LAURIE FUNERAL HOME PROFIT SHARING PLAN,

Respondents.

BRIEF OF PETITIONERS

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Second Circuit is reported at 788 F.2d 94, and is reproduced in the Petition for a Writ of Certiorari (the "Petition") at Appendix B. The opinion of the United States District Court for the Southern District of New York is reported at 618 F. Supp. 384, and is reproduced in the Petition at Appendix C.

JURISDICTION

The judgment of the court of appeals was entered on April 16, 1986. The Petition was timely filed on July 14, 1986 and was granted on October 6, 1986. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED*

United States Arbitration Act

Section 2, 9 U.S.C. § 2
Section 3, 9 U.S.C. § 3

Securities Act of 1933

Section 12(2), 15 U.S.C. § 77*l*(2)
Section 14, 15 U.S.C. § 77n
Section 22(a), 15 U.S.C. §77v(a)

Securities Exchange Act of 1934

Section 10(b), 15 U.S.C. § 78j(b)
Section 29(a), 15 U.S.C. § 78cc(a)

Racketeer Influenced and Corrupt Organizations Act

Section 1962, 18 U.S.C. § 1962
Section 1964(c), 18 U.S.C. § 1964(c)

Securities and Exchange Commission Regulation

Rule 10b-5, 17 C.F.R. § 240.10b-5

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* The text of these provisions is reproduced in full at Appendix A.

STATEMENT OF THE CASE

From February 1980 through July 1982, respondents Eugene and Julia McMahon, either individually, jointly, or on behalf of various trusts, signed a series of Customer Agreements with a predecessor of Shearson Lehman Brothers Inc. ("Shearson"), a registered broker-dealer. Each of these agreements provides for arbitration of any controversy relating to the various accounts respondents maintained at Shearson. (R. 15). A typical agreement provides in part:

> Unless unenforceable due to federal or state law, any controversy arising out of or relating to my accounts, to transactions with you for me or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules, then in effect, of the National Association of Securities Dealers, Inc. or the Boards of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange, Inc. as I [the customer] may elect.

On October 26, 1984, respondents filed an action against Shearson and its registered representative Mary Ann McNulty in the United States District Court for the Southern District of New York. Respondents claimed that their securities accounts were mishandled by their broker. They alleged that there had been excessive trading in their accounts, that false statements were made and material facts omitted from the advice given to them, and that certain securities they purchased were not appropriate for their particular investment objectives. Respondents claimed that this conduct constituted: (a) common-law fraud, (b) a breach of fiduciary duty, (c) a violation of § 10(b) of the Exchange Act and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5, and (d) a violation of § 1962 of the RICO statute. (R. 9). Shearson and Ms. McNulty moved for an order to enforce the arbitration agreement pursuant to § 3 of the United States Arbitration Act, 9 U.S.C. § 1 *et seq.*, which requires federal district court judges to compel arbitration of disputes encompassed by an arbitration agreement. (R. 10).

The District Court Opinion

The district court, Hon. Lloyd F. MacMahon, held that common-law causes of action are arbitrable under *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213 (1985). The court also conducted a two-part analysis and concluded that § 10(b) claims are arbitrable. The court initially conducted a statutory analysis similar to that used by this Court in *Wilko v. Swan*, 346 U.S. 427 (1953), wherein the Court refused to enforce a pre-dispute contractual agreement to arbitrate claims arising under § 12(2) of the Securities Act of 1933, 15 U.S.C. § 77*l*(2). The district court examined the distinctions between § 12(2) of the Securities Act, and § 10(b) of the Exchange Act, 15 U.S.C. § 78j(b) and concluded that the *Wilko* doctrine is inapplicable to claims asserted under § 10(b) of the Exchange Act for the following reasons: (1) the "special right" created by Congress in § 12(2) which shifts the burden of proving lack of *scienter* to the defendant is not present in § 10(b); (2) the cause of action under § 10(b) is judicially implied unlike the express cause of action created by Congress in § 12(2); and (3) jurisdiction under the Exchange Act is limited to the federal courts and therefore narrower than jurisdiction under the Securities Act. *McMahon v. Shearson/American Express, Inc.*, 618 F.Supp. 384, 388 (S.D.N.Y. 1985), *aff'd in part, rev'd in part*, 788 F.2d 94 (2d Cir. 1986).

The court then addressed the decision of the court of appeals in *Allegaert v. Perot*, 548 F.2d 432 (2d Cir.), *cert. denied*, 432 U.S. 910 (1977), which held that § 10(b) claims are nonarbitrable. *Allegaert* involved a suit brought by trustees of a bankrupt securities brokerage firm against the New York Stock Exchange, Inc., several of its corporate members, and four individuals, alleging violations of the Bankruptcy Act, 11 U.S.C. § 701 *et seq.* (1979), the Exchange Act and various state laws. The court considered the factors relied on by the court of appeals in *Allegaert:*

> [T]he [Second Circuit] examined the "public interest in the dispute, the degree to which the nature of the evidence made the judicial forum preferable to

> arbitration, and the extent to which the agreement was a product of free choice." Pointing out that the case was "a claim of wholesale fraud" brought on behalf of hundreds of creditors, the court determined that the claim was imbued with strong public interest and protective public policy considerations which were inappropriate for enforcement by arbitration.

McMahon, 618 F. Supp. at 389 (citing *Allegaert*, 548 F.2d at 436-38). The court distinguished the underlying facts of this case from *Allegaert*, focusing on the absence of strong public interests in what is essentially a garden-variety dispute between a broker and its customers:

> We are not presented here with claims involving fraud, nor industry-wide practices which may tend to ensnare an unsuspecting public. Plaintiffs' claim is simply that a single securities representative "churned" their accounts and made certain misrepresentations concerning the status of those accounts. Such a dispute over the management of an account neither raises broad issues of policy nor involves widespread industry practices and, therefore, touches none of the concerns at stake in *Allegaert* which mandate a judicial forum.

McMahon, 618 F. Supp. at 389 (citing *Greater Continental Corp. v. Schechter*, 422 F.2d 1100, 1103 (2d Cir. 1970)). Accordingly, the court enforced the agreement to arbitrate the § 10(b) claims asserted by respondents.

The district court also held that it was barred from enforcing the agreement to arbitrate respondents' RICO claims, simply stating:

> The RICO claim is not arbitrable because of the important federal policies inherent in the enforcement of RICO by the federal courts.

Id. at 387 (citing *S. A. Mineracao da Trindade-Samitri v. Utah Int'l.*, 576 F. Supp. 566, 574-76 (S.D.N.Y. 1983)).

The court stayed federal proceedings of the RICO claims pending arbitration of the arbitrable claims. (R. 23). Respondents appealed the district court's order enforcing the agreement to arbitrate the § 10(b) claims pursuant to 28 U.S.C. § 1292(a)(1), and petitioners cross-appealed the denial of their motion to arbitrate the RICO claims. (R. 24, 25).

The Court of Appeals Opinion

The court of appeals held that common-law claims are arbitrable, but refused to enforce the contractual agreement of the parties to arbitrate claims asserted under § 10(b) of the Exchange Act. The court's refusal to compel § 10(b) claims to arbitration was based on: (1) the *Wilko* Court's reliance on the anti-waiver provision in § 14 of the Securities Act, 15 U.S.C. § 77n, which prohibits arbitration of § 12(2) claims, combined with that section's similarity to the anti-waiver provision in § 29(a) of the Exchange Act, 15 U.S.C. § 78cc(a); in addition to (2) public policy considerations which the court held required a judicial forum for the resolution of securities disputes. The court concluded that § 10(b) disputes were "properly litigated in the courts where a complete record is kept of the proceedings and findings and conclusions are made." *McMahon v. Shearson/American Express, Inc.*, 788 F.2d 94, 97 (2d Cir. 1986) (citing *Schechter*, 422 F.2d at 1103). The court considered, but refused to accept, the district court's conclusion that broad public policy issues were not present in the dispute between the parties:

> While a churning claim by its nature is limited to the specific accounts in question, such claims also reflect the public interest and are important in their deterrent effect. The securities laws generally, and the implied causes of action which the courts have recognized, are designed to protect the public, and particularly the less sophisticated investor.

Id. at 98.

The court of appeals also refused to enforce the contractual agreement of the parties to arbitrate civil RICO claims, because of perceived "strong public policy considerations:"

> In other contexts, we have recognized the inappropriateness of the United States Arbitration Act when strong public policy considerations are involved. In *American Safety Equipment Corp. v. J. P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968), we stated that "a claim under the antitrust laws is not merely a private matter. The Sherman Act is designed to promote the national interest in a competitive economy; thus, the plaintiff asserting his rights under the Act has been likened to a private attorney-general who protects the public's interest." 391 F.2d at 826. We hold that there are comparable concerns inherent in the enforcement of RICO claims.

Id. The court of appeals considered the rationale underlying this Court's decision in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 105 S. Ct. 3346 (1985), which enforced a contractual agreement to arbitrate an international antitrust dispute, but nevertheless refused to extend *Mitsubishi* to the domestic arena. The court concluded:

> Enforcement of the RICO statute is particularly appropriate in a judicial forum because of strong policy concerns, the need for development of the record, and judicial clarification and resulting consistency in resolving disputes under this relatively new statute.

McMahon, 788 F.2d at 98-99.

SUMMARY OF ARGUMENT

Section 10(b) Claims Are Arbitrable

The refusal by the court of appeals to enforce an agreement between a broker-dealer and its customers to arbitrate claims asserted under § 10(b) of the Exchange Act conflicts with the explicit language and legislative history of the United States Arbitration Act as interpreted by this Court. Congress enacted the Arbitration Act in 1925 to overcome a long-standing judicial hostility to arbitration. The Act expresses congressional intent

to enforce contractual agreements of parties who desire a swift resolution of their disputes in an arbitral forum. H.R. Rep. No. 96, 68th Cong., 1st Sess. 1-2 (1924). This Court has consistently affirmed the national policy favoring arbitration of all arbitrable claims, and has held that a valid arbitration agreement shall be enforced as to a statutory claim unless Congress has evidenced a contrary intention in the statute or its legislative history. *Mitsubishi*, 105 S. Ct. at 3354-55.

An examination of the Exchange Act and its legislative history reveals no evidence of congressional intent to exclude claims asserted under § 10(b) of that statute from the mandate of the Arbitration Act. Accordingly, § 10(b) claims must be arbitrated when a valid arbitration agreement exists between contracting parties.

The contrary holding of the court of appeals is premised upon a misapplication of the Court's opinion in *Wilko v. Swan*, 346 U.S. 427 (1953). The *Wilko* Court held that Congress intended to create an exception to the Arbitration Act when it enacted § 12(2) of the Securities Act. The Court held that an agreement to arbitrate claims asserted under § 12(2) was a "stipulation" which waives compliance with § 22(a), 15 U.S.C. § 77v(a), the provision of the Securities Act that provides for concurrent federal and state court jurisdiction. *Wilko*, 346 U.S. at 434-35. Congress created in § 12(2) an express cause of action for purchasers of securities issued pursuant to an initial public offering which differs from the common-law fraud action because it shifts the burden of proof from plaintiff to defendant. 15 U.S.C. § 77*l*(2). The Court's holding was premised upon its belief that Congress would not want to entrust arbitrators with interpreting this unique "special right" without judicial instruction on the law and judicial review of an arbitrator's decision. *See Wilko*, 346 U.S. at 435-36.

The court of appeals noted the similarity between the anti-waiver provision contained in § 29(a) of the Exchange Act and its counterpart in § 14 of the Securities Act, and concluded, without further analysis, that Congress intended to prohibit waiver of the right to sue in federal court which is granted by § 27 of the Exchange Act. 15 U.S.C. § 78aa. The court's opinion

failed to address the *Wilko* Court's solicitude for the § 12(2) "special right." This right is not present in § 10(b), the elements of which more closely resemble that of arbitrable common-law fraud. The *Wilko* doctrine is inapplicable to § 10(b) solely on this basis.

The *Wilko* Court's anti-waiver analysis is also inapplicable to § 10(b), which is a judicially-created, implied right of action. Congress could not have intended to prohibit waiver of the right to assert § 10(b) claims in federal court when it never created a private cause of action under § 10(b) and, in fact, never even considered creating such an action. *See Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 196 (1976). Absent congressional intent, there is no basis for extending the *Wilko* Court's narrowly-crafted exception to the Arbitration Act for § 12(2) claims to prohibit arbitration of claims asserted under § 10(b) of the Exchange Act.

Although not a requirement for a finding that Congress did not intend to prohibit arbitration of claims asserted under § 10(b), this Court should nevertheless reject the *Wilko* Court's application of the anti-waiver provision to a jurisdictional clause. There is no evidence of congressional intent to support such an application. An anti-waiver provision applies to waiver of compliance with substantive liability under a statute, and should not be construed to bar a contractual agreement to enforce statutory rights in a congressionally-approved alternative forum. The *Wilko* Court's construction of an anti-waiver provision arises from the judicial mistrust of the arbitral forum for the resolution of statutory disputes which is inherent in the *Wilko* analysis. This mistrust is inconsistent with the congressional intent embodied in the Arbitration Act, and cannot be substantiated in light of the fair and efficient Security Regulatory Organization ("SRO") arbitral forums which exist for the resolution of securities disputes under the auspices of the congressionally-created Securities and Exchange Commission.

RICO Claims Are Arbitrable

The refusal by the court of appeals to enforce contractual agreements to arbitrate claims asserted under RICO is similarly unsupported by evidence of congressional intent deducible from

RICO or its legislative history. The RICO statute does not even contain an anti-waiver provision of the type found in the Securities Act and the Exchange Act. The public policy concerns relied on by the court of appeals constitute an impermissible basis for prohibiting arbitration of civil RICO claims when Congress has evidenced no intention to exempt civil RICO from the mandate of the Arbitration Act. These public policy concerns are nevertheless premised upon a misconception by the court of appeals that the deterrent purpose of civil RICO is more important than the congressional intent to compensate victims of organized crime. Arbitration forums are well equipped to compensate victims of civil RICO violations especially when, as here, the underlying RICO predicate offense is securities fraud. Furthermore, any public policy concerns are misplaced since the vast majority of civil RICO lawsuits involve routine commercial disputes having no connection with the congressional intent of halting the infiltration of legitimate business by organized crime.

ARGUMENT

I. The United States Arbitration Act Mandates Enforcement of Contractual Agreements to Arbitrate Statutory Claims Absent Congressional Intent to the Contrary.

The United States Arbitration Act provides that contractual agreements to arbitrate transactions involving commerce, "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The Act mandates that federal district courts shall direct the parties to an arbitration agreement to proceed to arbitration on issues as to which an arbitration agreement has been signed. 9 U.S.C. §§ 3-4. The language of the Act is the starting point in construing its application to statutory claims. *Randall v. Loftsgaarden*, 106 S. Ct. 3143, 3150 (1986) (citing *Sante Fe Industries, Inc. v. Green*, 430 U.S. 462, 477 (1977)). The Arbitration Act does not prohibit the enforcement of contractual agreements to arbitrate any particular type of claim, statutory or otherwise. The plain meaning of the Act requires the enforcement of arbitration agreements with respect to any arbitrable claims.

The legislative history of the Arbitration Act also supports the plain meaning of the Act, and further evidences congressional intent to enforce contractual agreements to arbitrate. The legislative history demonstrates that Congress enacted the Arbitration Act as a result of an anachronism of American law. Historically, English courts refused to enforce arbitration agreements because they were jealous of their own jurisdiction. H.R. Rep. No. 96, 68th Cong., 1st Sess. 1-2 (1924). As a result, this unwillingness to enforce arbitration agreements was firmly embedded in the English common law and was eventually adopted by the American courts. *Id.* at 2. Congress enacted the Arbitration Act to reverse this judicial hostility towards arbitration agreements:

> Arbitration agreements are purely matters of contract, and the effect of the bill is simply to make the contracting party live up to his agreement. He can no longer refuse to perform his contract when it becomes disadvantageous to him. An arbitration agreement is placed upon the same footing as other contracts, where it belongs.

Id. Congress also legislatively countenanced the ability of contracting parties to resolve their disputes in a manner which is simpler and more expeditious than federal or state litigation:

> [T]he party willing to perform his contract for arbitration is not subject to the delay and cost of litigation. Machinery is provided for the prompt determination of his claim for arbitration and the arbitration proceeds without interference by the court.

Id. at 2.

This Court has historically noted the strong congressional intent to favor arbitration agreements, and has instructed that they be liberally construed. *See, e.g., United Steelworkers of America v. Warrior and Gulf Navigation Co.*, 363 U.S. 574, 584-85 (1960). In recent case law, the Court has consistently affirmed the strong policies contained in the Arbitration Act,

notwithstanding the presence of other expressed judicial concerns. In *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983), the Court, in rejecting a district court's attempt to stay a federal action in which a party sought to compel arbitration in favor of a parallel state action, found that the Arbitration Act creates a body of "federal substantive law" which establishes and regulates the enforcement of arbitration agreements. The Court also held that "as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration . . . ." *Cone*, 460 U.S. at 24-25. Further articulation of the strong policies underlying the Arbitration Act are found in *Southland Corp. v. Keating*, 465 U.S. 1 (1984), which reversed a decision of the California Supreme Court that upheld a state statute precluding arbitration provisions in franchise agreements. This Court stated:

> We discern only two limitations on the enforceability of arbitration provisions governed by the Federal Arbitration Act: they must be part of a written maritime contract or a contract "evidencing a transaction involving commerce" and such clauses may be revoked upon "grounds as exist at law or in equity for the revocation of any contract." We see nothing in the Act indicating that the broad principle of enforceability is subject to any additional limitations under state law.

Southland, 465 U.S. at 10-11 (footnotes omitted). In *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213 (1985), the Court directly confronted the conflicting policies between the judicially-created "doctrine of intertwining" and the Arbitration Act. Some lower federal courts had developed the "doctrine of intertwining" in order to retain for judicial resolution arbitrable claims which they believed were sufficiently factually and legally intertwined with nonarbitrable claims under the federal securities laws.[1]

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[1] *See Belke v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 693 F.2d 1023, 1027 (11th Cir. 1982); *Miley v. Oppenheimer & Co.*, 637 F.2d 318, 334-37 (5th Cir. 1981); *Cunningham v. Dean Witter Reynolds, Inc.*, 550 F. Supp. 578, 580-85 (E.D. Cal. 1982). Other federal courts rejected the "doctrine of intertwining" so as to "not substitute [their] own views of economy and

(footnote continued)

These courts invoked this doctrine to preserve their exclusive jurisdiction over the Exchange Act and to promote judicial efficiency by avoiding "piecemeal litigation." *See Byrd*, 470 U.S. at 217. This Court subordinated both of these judicial concerns to the congressional intent embodied in the Arbitration Act:

> The preeminent concern of Congress in passing the Act was to enforce private agreements into which parties had entered, and that concern requires that we rigorously enforce agreements to arbitrate, even if the result is "piecemeal" litigation, at least absent a countervailing policy manifested in another federal statute.

Id. at 221. Most recently in *Mitsubishi*, this Court reaffirmed its longstanding national policy of enforcing agreements to arbitrate statutory disputes absent a countervailing policy manifested in another federal statute,[2] by ruling that antitrust disputes are arbitrable because there is no evidence in the antitrust statutes or their legislative history that Congress intended to preclude arbitration of these statutory claims. The Court rejected the notion that there is a pervasive public interest in the enforcement of antitrust claims that requires such claims to be heard in a judicial forum. *Mitsubishi*, 105 S. Ct. at 3355 (citing *American Safety Equip. Corp. v. J.P. Maguire & Co.*, 391 F.2d 821, 827-28 (2d Cir. 1968)).

The plain language and legislative history of the Arbitration Act must be examined in light of the principles articulated by this Court when analyzing whether Congress intended to prohibit enforcement of a contractual agreement to arbitrate a statutory claim. Only Congress can exempt a statutory claim from a valid arbitration agreement and the mandate of the Arbitration

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(footnote continued)
efficiency for those of Congress." *Byrd*, 470 U.S. at 217 (citing *Dickinson v. Heinold Securities, Inc.*, 661 F.2d 638, 646 (7th Cir. 1981)); *Surman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 733 F.2d 59, 62-63 (8th Cir. 1984); *Liskey v. Oppenheimer & Co.*, 717 F.2d 314, 317-21 (6th Cir. 1983).

[2] "Sometime ago this Court expressed hope for [the Arbitration Act's] usefulness both in controversies based on statutes or on standards otherwise created . . . . " *Mitsubishi*, 105 S.Ct. at 3354 (citing *Wilko*, 346 U.S. at 432).

Act, and any such congressional intent must be manifested in a statute or its legislative history. *Mitsubishi*, 105 S. Ct. at 3355; *Byrd*, 470 U.S. at 221; *Wilko*, 346 U.S. at 434-35.

II. Congress Did Not Intend to Create an Exception To the Arbitration Act Prohibiting the Enforcement Of Contractual Agreements to Arbitrate Claims Asserting an Implied Right of Action Under § 10(b) Of the Exchange Act.

This Court recently noted that the enforceability of an agreement to arbitrate a statutory claim is determined by examining congressional intent:

> We must assume that if Congress intended the substantive protection afforded by a given statute to include protection against waiver of the right to a judicial forum, that intention will be deducible from text or legislative history.

Mitsubishi, 105 S. Ct. at 3355. It is therefore necessary to scrutinize the text of § 10(b) and the Exchange Act as well as its legislative history to determine whether Congress intended to exempt this statute from the Arbitration Act.

Congress enacted the Securities Act in 1933, 15 U.S.C. § 77a *et seq.* (1982), and the Exchange Act in 1934 to regulate transactions in securities. The Securities Act was generally designed to provide investors with full disclosure of material information concerning public offerings of securities in commerce. *See* H.R. Rep. No. 85, 73d Cong., 1st Sess. 1-5 (1933). The Exchange Act was enacted to protect investors against the manipulation of stock prices through regulation of transactions consummated upon securities exchanges and in over-the-counter markets, and to impose regular reporting requirements on those companies which have stock listed on national securities exchanges. *See* S. Rep. No. 792, 73d Cong., 2d Sess. 1-5 (1934). Congress created the Securities and Exchange Commission by enacting § 4 of the Exchange Act, 15 U.S.C. § 78d, and provided the Commission with various enforcement powers. *See, e.g.*, Securities Act, Sections 8,

19, 20, 15 U.S.C. §§ 77h, 77s, 77t; Exchange Act, Sections 9, 19, 21, 15 U.S.C. §§ 78i, 78s, 78u.

Section 10(b) of the Exchange Act makes it unlawful for any person, by use of agencies of interstate commerce or the mails, "[t]o use or employ, in connection with the purchase or sale of any security," whether or not registered on a national securities exchange, "any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe." 15 U.S.C. § 78j(b). In furtherance of its enforcement and rulemaking powers, the Commission prescribed Rule 10b-5.[3] Although the explicit language of § 10(b) does not by its terms create an express civil remedy for its violation, and there is no indication in the legislative history of the Exchange Act that Congress in adopting § 10(b), or the Commission when promulgating Rule 10b-5, contemplated such a remedy,[4] a private right of action for violations of § 10(b) and Rule 10b-5 has been created by judicial implication and is well established. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 (1983); *Superintendent of Insurance v. Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n.9 (1971); *Kardon v. National Gypsum Co.*, 69 F. Supp. 512, 514 (E.D. Pa. 1946).

The mere existence of a judicially-created implied private right of action under § 10(b) does not evidence congressional intent to preclude arbitration of claims when parties have so contracted. It is one thing to infer that Congress intended a civil litigant to have the benefit of an implied right of action under § 10(b); it is quite another to infer that Congress intended to exempt § 10(b)

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[3] The full text of Rule 10b-5, 17 C.F.R. § 240.10b-5, is reproduced in its entirety at Appendix A.

[4] *See* L. Loss, *Fundamentals of Securities Regulation*, 821-22 (1983) (Section 10(b) was enacted to enable the Securities and Exchange Commission to investigate and obtain injunctive relief against corporate insiders who were buying their companies' stock. "[I] can vouch that nobody at the Commission table gave any indication that he was remotely thinking of civil liability."); *see also Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196 (1976); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 729-30 (1975).

claims from the plain meaning of the Arbitration Act. Such an inference requires a finding that Congress intended to repeal the Arbitration Act, enacted in 1925, by implication, when it enacted the Exchange Act in 1934. This Court does not routinely repeal statutes by implication:

> It is, of course, a cardinal principle of statutory construction that repeals by implication are not favored.

Radzanower v. Touche Ross & Co., 426 U.S. 148, 154 (1976) (citing *United States v. United Continental Tuna Corp.*, 425 U.S. 164, 168 (1976)). The Court has also articulated the standard for repeal of a statute by implication when Congress has not evidenced its intent on the issue:

> In the absence of some affirmative showing of an intention [by Congress] to repeal, the only permissible justification for a repeal by implication is when the earlier and later statutes are irreconcilable.

Morton v. Mancari, 417 U.S. 535, 550 (1974). The Arbitration Act and the Exchange Act are not irreconcilable. The purpose of the Arbitration Act is to enforce vigorously contractual agreements to arbitrate. H.R. Rep. No. 96, 68th Cong., 1st Sess. 1 (1924). The purpose of the Exchange Act is to protect investors against fraud in the secondary market. S. Rep. No. 792, 73d Cong., 2d Sess. 1-5 (1934). Both statutes co-exist without conflict. The Arbitration Act is applicable only when parties voluntarily enter into a contractual agreement to arbitrate. If there is no agreement to arbitrate, a claim under the Exchange Act will remain in court. However, if agreed to, a party's claim under § 10(b) of the Exchange Act should be heard in an arbitral forum. This does not amount to a waiver of the protections afforded under § 10(b); it only results in an agreed-to change of forum. "[W]hen two statutes are capable of co-existence, it is the duty of the courts . . . to regard each as effective." *Mancari*, 417 U.S. at 551. Since the Arbitration Act and the Exchange Act are

reconcilable, contractual agreements to arbitrate claims asserted under § 10(b) of the Exchange Act should be enforced.[5]

Notwithstanding the lack of congressional intent in the Exchange Act to exempt § 10(b) from the Arbitration Act, a few of the lower courts have chosen to rely, in various degrees, on language in the House Conference Report to the Securities Act Amendments of 1975, Pub. L. 94-29, 89 Stat. 97 (1975), as evidence of congressional intent to prohibit arbitration of § 10(b) claims. Congress amended § 28 of the Exchange Act in 1975 as part of its vast overhaul of the federal securities laws to preserve the right of securities exchanges and other self-regulatory organizations to adopt mechanisms for the resolution of their intramural disputes. The House Conference Report to the 1975 amendments contains the following language:

> It was the clear understanding of the conferees that this amendment did not change existing law, as articulated in *Wilko v. Swan*, 346 U.S. 427 (1953), concerning the effect of arbitration proceeding provisions in agreements entered into by persons dealing with members and participants of self-regulatory organizations.

H.R. Rep. No. 229, 94th Cong., 1st Sess. 111, *reprinted in* 1975 U.S. Code Cong. & Admin. News 179, 321, 342.

The plain meaning of this language expresses congressional intent that the 1975 amendments not change the *Wilko* holding that claims arising under § 12(2) of the Securities Act are nonarbitrable. It is unclear why the conferees felt compelled to mention *Wilko* within the context of their amendment to § 28 of the Exchange Act. However, it is most probable that the conferees were aware that the provisions of the Exchange Act and the Securities Act often overlap, and they wished to ensure that their

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[5] "Of course, courts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds 'for the revocation of any contract.' " *Mitsubishi*, 105 S. Ct. at 3354 (citing 9 U.S.C. § 2).

amendment to § 28 was not interpreted as a general congressional policy favoring arbitration of all securities disputes, since such a policy would include claims arising under § 12(2) of the Securities Act which *Wilko* held nonarbitrable. Apart from the plausibility of this construction of the House Conference Report, the plain language of the Report refers strictly to the holding in *Wilko* as it applies to pre-dispute agreements to arbitrate claims asserted under § 12(2) of the Securities Act.

A few lower courts have ascribed to a unique theory. These courts speculate that since Congress was aware of the *Wilko* decision it was also aware that as of 1975 one circuit court of appeals had extended the *Wilko* doctrine to § 10(b) claims. *See Moran v. Paine, Webber, Jackson & Curtis Inc.*, 389 F.2d 242 (3d Cir. 1968). These courts surmise that Congress impliedly consented to the *Moran* extension of *Wilko* to § 10(b) by not expressly amending the Exchange Act in 1975 to allow for arbitration of § 10(b) disputes between customers and broker-dealers. *See Conover v. Dean Witter Reynolds, Inc.*, 794 F.2d 520, 523-24 (9th Cir. 1986); *Wolfe v. E.F. Hutton & Co.*, 800 F.2d 1032, 1037-38 (11th Cir. 1986) (en banc).

This analysis leads to a different conclusion when developed more fully. An assumption that Congress was aware of a 1968 Third Circuit case is unreasonable. It is more logical to assume that Congress was aware of and deferred to this Court's 1974 decision in *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974), which was rendered during a year in which congressional deliberations regarding the 1975 amendments were ongoing. Congress was then aware that the Supreme Court had specifically recognized that the *Wilko* doctrine did not necessarily apply to § 10(b). *Scherk*, 417 U.S. at 513-14. Since the conferees were aware that the *Wilko* doctrine applied only to § 12(2) of the Securities Act when they amended § 28 of the Exchange Act, the language in the House Report must be viewed as an indication of congressional intent to maintain the status quo.

The 1975 amendments to the federal securities laws did not involve arbitration of disputes between customers and broker-dealers. Therefore, there is no basis to broadly interpret the

language in the House Conference Report as an expression of congressional policy in this area. This Court has recognized the limited value of inference from congressional silence. *Girouard v. United States*, 328 U.S. 61, 69 (1946) ("it is at best treacherous to find in congressional silence alone the adoption of a controlling rule of law"). There is no clear evidence in the "one ambiguous sentence" in the House Conference Report which would suggest a congressional intent to prohibit enforcement of agreements to arbitrate § 10(b) claims. *Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 795 F.2d 1393, 1398 n.17 (8th Cir. 1986) (agreements to arbitrate § 10(b) claims enforceable); *see Hirschey v. F.E.R.C.*, 777 F.2d 1, 7-8 (D.C. Cir. 1985) (Scalia, J. concurring) (criticizing routine deference to the detail of congressional committee reports.). The absence in the Exchange Act and its legislative history of evidence expressing congressional intent to exempt claims asserted under § 10(b) of the Exchange Act from the Arbitration Act allows for only one conclusion. Congress intended to enforce contractual agreements of parties to arbitrate § 10(b) claims.

A. *Wilko v. Swan* Should Not Be Extended to Prohibit Enforcement of Agreements to Arbitrate Claims Asserted Under § 10(b) of the Exchange Act.

Numerous circuit courts of appeals have assumed that § 10(b) claims are nonarbitrable notwithstanding the absence of congressional intent supporting this position.[6] This assumption is based upon the Court's opinion in *Wilko* which involved a claim asserted under § 12(2) of the Securities Act[7] by a customer against

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[6] *See Surman*, 733 F.2d at 61-62; *Belke*, 693 F.2d at 1025-26; *DeLancie v. Birr, Wilson & Co.*, 648 F.2d 1255, 1258-59 (9th Cir. 1981); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1030 (6th Cir. 1979); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore*, 590 F.2d 823, 827-29 (10th Cir. 1978); *Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 558 F.2d 831, 833-35 (7th Cir. 1977); *Allegaert*, 548 F.2d at 436-38; *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532, 536 (3d Cir.), *cert. denied*, 429 U.S. 1010 (1976); *Sibley v. Tandy Corp.*, 543 F.2d 540, 543 (5th Cir. 1976), *cert. denied*, 434 U.S. 824 (1977).

[7] Section 12(2) of the Securities Act, 15 U.S.C. § 77*l* (2), is reproduced in its entirety at Appendix A.

his stockbroker to recover damages as a result of alleged misrepresentations and omissions concerning a purchase of shares of common stock. The respondents in *Wilko* moved to stay the action under § 3 of the Arbitration Act pending arbitration of the dispute, pursuant to the broad arbitration agreement executed by the petitioner. The motion was denied by the district court. The court of appeals reversed, holding that § 12(2) claims were arbitrable since the plain meaning and strong policies evidenced by the Arbitration Act were superior to the policies underlying the Securities Act. *Wilko v. Swan*, 201 F.2d 439, 445 (2d Cir.), *rev'd*, 346 U.S. 427 (1953).

The *Wilko* Court reversed the decision of the court of appeals and held that a pre-dispute agreement to arbitrate claims asserted under § 12(2) of the Securities Act is void. The Court interpreted such an agreement to be a "stipulation" which waives compliance with § 22(a), the provision of the Securities Act that provides for concurrent federal and state court jurisdiction. *Wilko*, 346 U.S. at 434-35.

The Court's conclusion that the right to select the judicial forum to enforce § 12(2) claims is the kind of "provision" that cannot be "waived" under § 14 of the Securities Act [8] was based on its perception of several characteristics unique to § 12(2) and the Securities Act. First, the Act was designed to protect securities investors by requiring that issuers, underwriters and dealers of securities make full and fair disclosure of the character of securities sold in interstate and foreign commerce, and to prevent fraud in connection with such sales. *Id.* at 431. Second, § 12(2) of the Securities Act grants a "special right" to aggrieved purchasers of securities to effectuate the aim of the Securities Act. *Id.* The Court interpreted § 12(2) to create "a special right to recover for misrepresentation which differs substantially from the common-law action in that the seller is made to assume the burden of proving lack of scienter." *Id.* Third, the Court stated

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[8] Section 14 provides: "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this title or of the rules and regulations of the Commission shall be void." 15 U.S.C. § 77n.

that other factors, when taken together, militate against enforcing pre-dispute agreements to arbitrate § 12(2) claims. The "special right" created by § 12(2) is enforceable in any court of competent jurisdiction – federal or state – and removal from state court is prohibited. Additionally, a purchaser who brings suit in federal court has a wide choice of venue, the privilege of nationwide service of process, and the ability to escape the monetary jurisdictional requirement attendant to diversity cases since subject matter jurisdiction pertains to a federal question. *Id.*

The *Wilko* Court also expressed doubts about the capability of arbitrators to adjudicate § 12(2) claims and properly ensure that purchasers of securities receive the protections afforded by the congressionally-created "special right." The Court opined:

> Even though the provisions of the Securities Act, advantageous to the buyer, apply, their effectiveness in application is lessened in arbitration as compared to judicial proceedings.

Id. at 435. The Court held that the express congressional intent embodied in the "special right" created by § 12(2) provides a unique mechanism for the protection of investors in connection with the sale of securities which overrides the strong congressional policies inherent in the Arbitration Act. *See id.* Accordingly, the Court held that a contractual agreement to arbitrate claims asserted under § 12(2) of the Securities Act is void pursuant to § 14 of that Act.

1. Section 10(b) of the Exchange Act does not contain the "special right" granted by Congress to purchasers of securities in § 12(2) of the Securities Act.

The court of appeals extended the *Wilko* doctrine to claims asserted under § 10(b) of the Exchange Act based on the following factors:

> [T]he similarity of the non-waiver provisions, § 14 of the 1933 Act and § 29(a) of the 1934 Act, as well as

> the strong policy concerns inherent in the securities laws and the legislative history that preceded their enactment, support the compelling need for a judicial forum in the resolution of securities law disputes.

McMahon, 788 F.2d at 98. The deficiency in this analysis is that it fails to address characteristics unique to § 12(2) and the Securities Act which caused the *Wilko* Court to carve out a limited exception to the Arbitration Act:

> [T]he *Securities Act* was drafted with an eye to the disadvantages under which buyers labor. Issuers of and dealers in securities have better opportunities to investigate and appraise the prospective earnings and business plans affecting securities than buyers. It is therefore reasonable for Congress to put buyers of securities covered by *that Act* on a different basis from other purchasers.

Wilko, 346 U.S. at 435 (emphasis added). To compensate for the disadvantages of purchasers of securities issued pursuant to an initial public offering, the Securities Act requires issuers, underwriters, and dealers to make full and fair disclosure of the character of securities sold in interstate commerce. *Id.* at 431.

Congress created the "special right" in § 12(2) to effectuate the significant policies underlying the Securities Act. It is clear from the language in *Wilko* that the shifting of the burden of proof – the creation by Congress of the "special right" – was the primary reason why the *Wilko* Court found that Congress intended to exempt claims asserted under § 12(2) of the Securities Act from the Arbitration Act. Section 10(b) of the Exchange Act is devoid of this "special right." When enforcing a § 10(b) claim, the plaintiff sustains the burden of proof. *Ernst & Ernst*, 425 U.S. at 193.

A plaintiff suing under § 12(2) of the Securities Act is also entitled to the following procedural rights created by Congress

to enforce the "special right" embodied in § 12(2): (1) concurrent state and federal court jurisdiction; (2) prohibition against removal from state court if suit is brought there; (3) a broad choice of venue; (4) the privilege of nationwide service of process; and (5) the lack of the jurisdictional monetary requirement attendant to diversity cases. *Wilko*, 346 U.S. at 433. Although a plaintiff asserting a claim under § 10(b) enjoys the benefit of a broad choice of venue, nationwide service of process, and the lack of the jurisdictional monetary requirement attendant to diversity cases, any emphasis on the respective procedural rights offered by the Securities Act and the Exchange Act is misplaced since the *Wilko* Court found these procedural rights significant only to the extent they enable a defrauded purchaser to enforce the "special right" present in § 12(2).[9]

In addition to the "special right" to shift the burden of proof emphasized by the *Wilko* Court, Congress in § 12(2) created a cause of action whereby a purchaser can recover for misrepresentation without proving intent on the part of the seller. In contradistinction, a plaintiff asserting a cause of action under § 10(b) must prove *scienter* on the part of the defendant as he would in an action for common-law fraud. *Ernst & Ernst*, 425 U.S. at 193. Therefore, the § 10(b) implied right of action "is not so different" from a common-law fraud action which must be sent to arbitration when a motion to compel arbitration is made. *Byrd*, 470 U.S. at 225 (White, J. concurring).

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[9] Although not a consideration in *Wilko*, § 12(2) also enables the victim of prospectus fraud to demand rescission upon tender of the security, evidencing congressional intent to shift the risk of decline in the security's value to the seller. This provides § 12(2) with an additional measure of deterrence not found in § 10(b) which, pursuant to § 28(a) of the Exchange Act, 15 U.S.C. § 78bb(a), limits a buyer's recovery to compensatory or "actual" damages. *Randall v. Loftsgaarden*, 106 S. Ct. at 3151. *But see Blackie v. Barrack*, 524 F.2d 891, 909 (9th Cir. 1975) ("[w]hile out of pocket loss is the ordinary standard in a 10b-5 suit, it is within the discretion of the district judge in appropriate circumstances to apply a rescissory measure"), *cert. denied*, 429 U.S. 816 (1976); *see Affiliated Ute Citizens v. United States*, 406 U.S. 128, 155 (1972) ("where the defendant received more than the seller's actual loss . . . . damages are the amount of the defendant's profit").

The unique characteristics of § 12(2) and the Securities Act simply are not found in § 10(b) and the Exchange Act. Although the conduct prohibited by the statutes may overlap at times, a cause of action under § 10(b) and a cause of action under § 12(2) differ in material respects as to their elements, defenses, and measures of damages. The court of appeals did not address these material differences which preclude the application of the *Wilko* doctrine to § 10(b) of the Exchange Act. Furthermore, the reliance by the court of appeals on the semantic similarity of the anti-waiver provisions in both statutes as a basis to prohibit arbitration of claims asserted under § 10(b) is misplaced.

2. The anti-waiver provision in § 29(a) of the Exchange Act does not preclude enforcement of agreements to arbitrate the § 10(b) cause of action which was not expressly created by Congress.

The *Wilko* Court held that a contractual agreement to arbitrate a § 12(2) claim is void under the anti-waiver provision found in § 14 of the Securities Act, as a stipulation waiving compliance with § 22(a) of that Act, which section grants a plaintiff the right to sue in state or federal court.[10] The Court's conclusion was based on its interpretation of congressional intent and its assumption that Congress, in enacting § 14, intended to prohibit arbitration of § 12(2) claims:

> As the protective provisions of the Securities Act require the exercise of judicial direction to fairly assure their effectiveness, it seems to us that Congress must have intended § 14 to apply to waiver of judicial trial and review [of § 12(2) claims].

Wilko, 346 U.S. at 437 (citation and footnote omitted). This analysis simply cannot be transferred to § 10(b) of the Exchange Act, even assuming the validity of the analysis with respect to an express cause of action such as § 12(2) of the Securities Act. The court of appeals erred by merely noting the similarity between § 14 and § 29(a) and not analyzing the significant differences between § 12(2) and § 10(b).

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[10] Section 22(a) of the Securities Act, 15 U.S.C. § 77v(a), is reproduced in its entirety at Appendix A.

Section 29(a) of the Exchange Act provides:

> Any condition, stipulation, or provision binding any person to *waive compliance with any provision of this chapter* or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

15 U.S.C. § 78cc(a) (emphasis added). While the phrase "waive compliance with any provision of this chapter" is virtually identical to its counterpart in § 14 of the Securities Act, it is nevertheless literally inapplicable to an implied right of action under § 10(b). *Byrd*, 470 U.S. at 225 (White, J. concurring). While the existence of a judicially-created implied right of action under § 10(b) is undisputed, it is also undisputed that Congress never considered or intended for there to be a private remedy under § 10(b). *Ernst & Ernst*, 425 U.S. at 196. Since Congress did not create an express cause of action under § 10(b), and, in fact, did not consider the issue of civil liability under § 10(b) at all, it could not have intended the anti-waiver provision found in § 29(a) of the Exchange Act to prohibit waiver of the judicial forum for claims asserted under § 10(b). Absent congressional intent to the contrary, § 10(b) of the Exchange Act is subject to the mandate of the Arbitration Act. *See Mitsubishi*, 105 S.Ct. at 3355.

In fact, this Court has never refused to enforce a contractual agreement to arbitrate an implied right of action. On those few occasions when the Court has refused to enforce an agreement to arbitrate a statutory claim, it has done so in recognition of an express remedy created by Congress:

> The Court has repeatedly held that a decision by Congress to create a special statutory remedy renders a private agreement to arbitrate a federal statutory claim unenforceable. Thus, as I have already noted, the *express* statutory remedy, provided in the Ku Klux Klan Act of 1871, the *express* statutory remedy in the Securities Act of 1933, the *express* statutory remedy in the Fair Labor Standards Act, and the *express* statutory remedy in Title VII of the Civil Rights Act of 1964, each provided the Court with convincing

> evidence that Congress did not intend the protections afforded by the statute to be administered by a private arbitrator.

Mitsubishi, 105 S. Ct. at 3366-67 (Stevens, J. dissenting) (emphasis added) (footnotes omitted). It is clear that statutory claims are subject to the unequivocal language of the Arbitration Act. *See id.* However, the application of the Exchange Act's anti-waiver provision to the implied right of action under § 10(b) is unclear. When balanced, the clear congressional intent manifested in the Arbitration Act and its legislative history override this questionable application.

3. This Court has recognized that the *Wilko* doctrine does not necessarily apply to § 10(b) of the Exchange Act.

This Court first questioned *Wilko's* applicability to § 10(b) of the Exchange Act in *Scherk*, due to the significant differences between § 12(2) of the Securities Act and § 10(b). In *Scherk*, the Court was presented with the question of whether a contractual agreement to arbitrate claims asserted under § 10(b) was enforceable in an international context. The Court recognized that:

> [A] colorable argument could be made that even the semantic reasoning of the *Wilko* opinion does not control the case before us. *Wilko* concerned a suit brought under § 12(2) of the Securities Act of 1933, which provides a defrauded purchaser with the "special right" of a private remedy for civil liability. There is no statutory counterpart of § 12(2) in the Securities Exchange Act of 1934, and neither § 10(b) of that Act nor Rule 10b-5 speaks of a private remedy to redress violations of the kind alleged here. While federal case law has established that § 10(b) and Rule 10b-5 create an implied private cause of action, the Act itself does not establish the "special right" that the Court in *Wilko* found significant. Furthermore, while both the Securities Act of 1933 and the Securities Exchange Act

> of 1934 contain sections barring waiver of compliance with any "provision" of the respective Acts, certain of the "provisions" of the 1933 Act that the Court held could not be waived by *Wilko's* agreement to arbitrate find no counterpart in the 1934 Act.

Scherk, 417 U.S. at 513-14 (citations and footnotes omitted). The *Scherk* Court nevertheless based its decision to allow arbitration of § 10(b) claims on the international factual setting involved and the Court's attendant concerns for international comity, international conflict-of-laws problems, and a desire to provide parties to an international agreement with the certainty of knowing where their rights will be enforced if a dispute arises. *Id.* at 515-20. The Court chose not to expressly resolve the question of the *Wilko* doctrine's applicability to § 10(b) of the Exchange Act. *Id.* at 515.

Notwithstanding the "colorable argument" articulated in *Scherk*, which limits the *Wilko* doctrine to § 12(2) of the Securities Act, the lower federal courts had steadfastly refused to enforce contractual agreements to arbitrate claims asserted under § 10(b). *See* note 6. This trend was reversed when this Court issued its opinion in *Byrd* and noted that the arbitrability of § 10(b) claims was still an open question. *Byrd*, 470 U.S. at 215-16 n.1. Moreover, Justice White wrote separately in the concurring opinion in *Byrd* to express his belief that the applicability of the *Wilko* doctrine to § 10(b) claims "is a matter of substantial doubt." *Id.* at 224 (White, J. concurring). After thoroughly analyzing and comparing the elements of § 12(2) of the Securities Act and § 10(b) of the Exchange Act, Justice White concluded:

> *Wilko's* solicitude for the federal cause of action – the "special right" established by Congress – is not necessarily appropriate where the cause of action is judicially implied and not so different from the common-law action.

Id. at 225 (citations and footnote omitted). Justice White further admonished that "*Wilko's* reasoning cannot be mechanically transplanted to the 1934 Act." *Id.* at 224. Subsequently, a

majority of the district courts which reexamined the elements of § 12(2) and § 10(b) held that contractual agreements to arbitrate 10(b) claims are enforceable.[11] When these cases reached the various circuit courts of appeals, these courts, with one exception, uniformly adhered to their precedents arrived at prior to *Byrd* and held § 10(b) claims nonarbitrable.[12] An objective analysis reveals that the *Wilko* doctrine is limited to the unique elements found in § 12(2) and the Securities Act. Since § 10(b) does not contain these elements, there is no reason to exempt claims asserted under that section from the strict mandate of the Arbitration Act.

B. Congress Intended an Anti-Waiver Provision to Prohibit Waiver of Substantive Compliance With A Statute and Not to Preclude Enforcement of Statutory Rights in an Arbitral Forum.

This Court can enforce agreements to arbitrate claims asserted under § 10(b) of the Exchange Act by recognizing the important differences between § 12(2) and § 10(b) and refusing to extend the *Wilko* doctrine. Without overruling *Wilko*, this Court can, and should, reject the *Wilko* Court's statutory construction of the anti-waiver provision contained in § 14 of the Securities Act to prohibit waiver of the judicial forum

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[11] At the time the Petition was filed, petitioners were aware of 118 district court decisions ruling on the enforceability of agreements to arbitrate § 10(b) claims since *Byrd* was decided. Seventy-six decisions, or approximately 64%, held that § 10(b) claims were arbitrable, while 42 decisions, or approximately 36%, held that § 10(b) claims were nonarbitrable. A complete list of these district court decisions is contained in the Petition at Appendix E.

[12] *See McMahon*, 788 F.2d at 96-98; *Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 797 F.2d 1197, 1201-02 (3d Cir. 1986); *Wolfe v. E. F. Hutton & Co.*, 800 F.2d 1032, 1038 (11th Cir. 1986) (en banc); *Mayaja, Inc. v. Bodkin*, 803 F.2d 157, 162 (5th Cir. 1986). Only two courts of appeals purported to analyze the issue of *Wilko*'s applicability to § 10(b) of the Exchange Act free from the restraint of prior precedent. *See Conover*, 794 F.2d at 527 (agreements to arbitrate § 10(b) claims unenforceable); *Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 795 F.2d 1393, 1398 (8th Cir. 1986) (agreements to arbitrate § 10(b) claims enforceable).

in favor of the arbitral forum for the resolution of § 12(2) claims, since this application was not based on congressional intent. *Wilko*, 346 U.S. at 437.

The *Wilko* Court's analysis was predicated upon two assumptions: (1) § 12(2) claims cannot adequately be resolved in an arbitral forum because arbitrators are incapable of properly making subjective findings about the purpose and knowledge of an alleged violator of the law without judicial instruction on the law; and (2) there are inadequate provisions in the Arbitration Act for judicial review of arbitration awards:

> As the protective provisions of the Securities Act require the exercise of judicial direction to fairly assure their effectiveness, it seems to us that Congress *must have intended* § 14 to apply to waiver of judicial trial and review.

Id. (citation and footnote omitted) (emphasis added). As a result of these assumptions, the Court concluded:

> This arrangement to arbitrate is a "stipulation," and we think the right to select the judicial forum is the kind of "provision" that cannot be waived under § 14 of the Securities Act.

Id. at 434-35.

The *Wilko* Court relied on its own concerns and assumptions about the doubts Congress must have had about the arbitral process notwithstanding the lack of any support for this position in the Arbitration Act.[13] The Arbitration Act, however, expresses

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[13] The *Wilko* Court also stressed the fact that a pre-dispute arbitration agreement would cause a security buyer to surrender one of the advantages of the Securities Act "at a time when he is less able to judge the weight of the handicap the Securities Act places upon his adversary." *Wilko*, 346 U.S. at 435. This assumption reflects judicial concerns not expressed in any portion of the Securities Act, which must in any event be subordinated to the express congressional approval of pre-dispute arbitration agreements in the Arbitration

(footnote continued)

clear congressional approval of arbitration as an alternative means for resolving disputes.[14] If Congress intended an anti-waiver provision to manifest a policy countervailing that of the Arbitration Act, this intent would be expressed in the language of a statute or its legislative history. Neither the Securities Act nor its legislative history expresses such an intent. Quite to the contrary, the plain meaning of § 14 prohibits pre-dispute agreements to waive substantive liability for violations of the Securities Act and does not preclude parties from voluntarily agreeing to resolve their disputes in an arbitral forum.[15] Section 14 voids contractual agreements whereby one party attempts to bind another party to a pre-dispute release from the duty of substantive "*compliance* with any provision of the [Securities Act]." 15 U.S.C. § 77n (emphasis added).

The interpretation of an anti-waiver provision to preclude waiver of substantive liability is supported by examining the historical application of such a provision. As recognized by a

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(footnote continued)

Act. If any credence is given to this theory, however, it must be limited to cases involving the express "special right" of § 12(2). An extension of this policy to § 10(b) claims would, in effect, require judicial voidance of pre-dispute agreements to arbitrate any statutory dispute notwithstanding the broad congressional mandate to the contrary.

[14] The *Wilko* Court recognized the congressional approval of the arbitral forum, although it did not find it dispositive:

> Congress has afforded participants in transactions subject to its legislative power an opportunity generally to secure prompt, economical and adequate solution of controversies through arbitration if the parties are willing to accept less certainty of legally correct adjustment.

Wilko, 346 U.S. at 438 (footnote omitted).

[15] "By agreeing to arbitrate a statutory claim, a party does not forego the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than judicial, forum. It trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration." *Mitsubishi*, 105 S. Ct. at 3355.

noted securities law commentator, anti-waiver provisions were first applied in England. L. Loss, *Fundamentals of Securities Regulation* at 1189 n.51. Prior to 1900, English courts had honored stipulations which bound purchasers of securities to waive *substantive compliance* with statutory provisions so long as the courts were satisfied that the party waiving his substantive rights was not deceived into signing the agreement. *See, e.g., Greenwood v. Leather Shod Wheel Co.*, [1900] 1 Ch. 42 (C.A.); *Cackett v. Keswick*, [1902] 2 Ch. 456 (C.A.).

In response to the enforcement by the English courts of pre-dispute waiver agreements, the Parliament enacted identical anti-waiver provisions in sections 38(2) and 417(2) of the Companies Act of 1900:

> A condition requiring or binding an applicant for shares in or debentures of a company to waive compliance with any requirement . . . shall be void.

11 & 12 Geo. 6, ch. 38, §§ 38(2), 417(2). This provision was intended to prevent parties from waiving *substantive compliance* with the Companies Act which prevented misrepresentations in connection with the sale of securities that were the subject of a prospectus. *See* 84 Parl. Deb. (4th ser.) 1161 (1900). Since the enactment of the anti-waiver provisions in England, sellers of securities have been precluded from enforcing pre-dispute agreements wherein purchasers waived their right to enforce substantive compliance with the law. L. Loss, *Fundamentals of Securities Regulation* at 1189 n.52. Nothing in English common law, statute, or parliamentary history supports the *Wilko* Court's application of an anti-waiver provision to a jurisdictional clause.

The propriety of interpreting an anti-waiver provision to preclude waiver of substantive statutory liability was recently recognized by a circuit court of appeals judge:

> Were I writing on a clean slate, I might well be inclined to reach a result contrary to the *Wilko* Court. Section 14 of the 1933 Act renders void any provision

> binding a security purchaser to "waive compliance with any provision of the subchapter" or the relevant rules and regulations thereunder. A fair reading of this statute would prevent a purchaser from waiving a seller's compliance with the substantive provisions of the Act, *i.e.*, its reporting and disclosure requirements. By agreeing to arbitrate, the purchaser does not waive the Act's protection, but merely agrees to enforce the Act's provisions in a forum other than the courts.

Wolfe v. E. F. Hutton & Co., 800 F.2d 1032, 1039 (11th Cir. 1986) (en banc) (Tjoflat, J. concurring); *see also* Fletcher, *Privatizing Securities Disputes Through the Enforcement of Arbitration Agreements*, 71 Minn. L. Rev. ____ (1987) (forthcoming Feb. 1987).

The *Wilko* Court's misinterpretation of the anti-waiver provision contained in § 14 of the Securities Act is highlighted by case law which has followed *Wilko*. In *Scherk*, this Court enforced a contractual agreement to arbitrate claims asserted under § 10(b) of the Exchange Act in an international context even though § 29(a) of the Exchange Act prohibits a stipulation "binding any person to waive compliance with any provision" of that Act which provides for exclusive jurisdiction in the federal district courts. Section 27, 15 U.S.C. § 78aa. Additionally, lower courts have agreed with Justice Jackson's concurring opinion in *Wilko* and have held that agreements to arbitrate § 12(2) claims entered into *after* a dispute has arisen are enforceable. *See, e.g., Coenen v. R. W. Pressprich & Co.*, 453 F.2d 1209, 1213 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972); *Gardner v. Shearson, Hammill & Co.*, 433 F.2d 367, 368 (5th Cir. 1970) (per curiam), *cert. denied*, 401 U.S. 978 (1971). These courts also allow parties to settle § 12(2) and § 10(b) claims without judicial approval, and to voluntarily submit these claims to arbitration. If the *Wilko* interpretation of an anti-waiver provision was correct, these judicially-created exceptions to § 14 and § 29(a) must be deemed impermissible usurpations of congressional authority. The proper interpretation is that an anti-waiver provision precludes an agreement whereby a purchaser waives his right to enforce a seller's

compliance with the substantive provisions of the law, and does not preclude a purchaser from agreeing to enforce those rights in a congressionally-approved alternative forum.

C. The Court of Appeals Erred by Relying On the *Wilko* Court's Misplaced and Outdated Concerns Regarding the Adequacy of Arbitral Forums to Resolve Federal Securities Law Disputes.

The *Wilko* Court's refusal to enforce a contractual agreement to arbitrate a § 12(2) claim was based in large part on its belief that arbitrators are not capable of adequately resolving such disputes. As the Court opined:

> Even though the provisions of the Securities Act, advantageous to the buyer, apply, their effectiveness in application is lessened in arbitration as compared to judicial proceedings. Determination of the quality of a commodity or the amount of money due under a contract is not the type of issue here involved. This case requires subjective findings on the purpose and knowledge of an alleged violator of the Act. They must be not only determined but applied by the arbitrators without judicial instruction on the law.

Wilko, 346 U.S. at 435-36. The *Wilko* Court's concerns are misplaced, and reflect a judicial mistrust of the arbitral process which was rejected by Congress when it enacted the Arbitration Act. Approximately thirty-five years after *Wilko*, these same doubts concerning arbitration of statutory disputes were expressed, without further analysis, by the court of appeals:

> [A]lleged violations of [§ 10(b) are] properly litigated in the courts where a complete record is kept of the proceedings and findings and conclusions are made.

McMahon, 788 F.2d at 97 (citing *Schechter*, 422 F.2d at 1103).

The concerns of the *Wilko* Court and the court of appeals are at variance with the view of this Court which recently reaffirmed its belief that the arbitral process is quite capable of

handling complex litigation:

> [W]e are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution.

Mitsubishi, 105 S. Ct. at 3354. The Court's conclusion is even more applicable to securities arbitration. Even assuming that the *Wilko* Court's mistrust of the arbitral process was justified in 1953, arbitration procedures for the resolution of securities disputes have become increasingly sophisticated since *Wilko* was decided. Carefully developed procedures have been established by the securities industry under the auspices of the Securities and Exchange Commission.[16]

In June 1976, the Securities and Exchange Commission solicited comments from interested persons in furtherance of its plan to develop "a uniform system of dispute grievance procedures" for the resolution of securities disputes. SEC Securities Exchange Act Release No. 12528 (June 9, 1976), 9 S.E.C. Docket 833-35 (1976). In response to proposals submitted by the SROs, a Securities Industry Conference on Arbitration (hereinafter SICA), consisting of representatives of various SROs, the Securities Industry Association, Inc. and the public, was established in 1977. *See* Katsoris, *Arbitration of a Public Securities Dispute*, 53 Fordham L. Rev. 279, 283-84 (1984) (hereinafter Katsoris, *Arbitration*). SICA developed a comprehensive Uniform Code of Arbitration setting forth procedures to be followed in the arbitration of customer disputes with broker-dealers. The Uniform Code was adopted by the participating SROs during 1979 and 1980.[17] SICA has continued to meet

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[16] *See, e.g.*, Constitution of New York Stock Exchange, Inc., Art. XI, 2 N.Y.S.E. Guide (CCH) ¶¶ 1501-1503 (June 1985); Arbitration Rules 600-634 of the New York Stock Exchange, Inc., 2 N.Y.S.E. Guide (CCH) at ¶¶ 2600-2634 (Mar. 1985). *See also* Uniform Code of Arbitration, N.A.S.D. Manual (CCH) ¶¶ 3712-3743 (July 1986).

[17] Included among the participating SROs are the American Stock Exchange, Inc., the New York Stock Exchange, Inc., the Chicago Board Options

(footnote continued)

periodically to supplement and amend the Uniform Code as necessary. *Id.* at 284.

The Uniform Code of Arbitration was approved by the Securities and Exchange Commission which found it to be in the public interest and in furtherance of just and equitable principles of trade. *See* SEC Securities Exchange Act Release No. 16390 (Nov. 30, 1979), 18 S.E.C. Docket 1197 (1979). The Commission retains jurisdiction to correct any perceived abuses or unfairness in the arbitration rules, pursuant to § 19 of the Exchange Act, 15 U.S.C. § 78s. Section 19(b) of the Act requires the SROs to file copies of any proposed rule change with the Commission, which publishes notice of the proposed rule change and gives interested persons an opportunity to submit their views on the proposal. 15 U.S.C. § 78s(b). At the conclusion of this process, the Commission either approves or disapproves the change. This procedure applies to changes in the SRO arbitration rules, and it adds a further measure of public protection which did not exist when *Wilko* was decided.

The public customer is further protected by the Uniform Code's requirement that the SROs appoint arbitration panels which consist of a majority of arbitrators who are not affiliated with the securities industry. The public customer may, however, request an arbitration panel which consists of a majority of arbitrators from the securities industry. Katsoris, *Arbitration* at 285.

The concerns of the *Wilko* Court regarding the ability of arbitrators to apply the federal securities laws to the factual disputes before them are outdated. Arbitrators are generally selected by the various arbitration forums based upon their expertise in particular areas of the law. They are knowledgeable individuals who have experience working with these laws, such as attorneys specializing in securities law and retired judges, as well as businessmen and other individuals with extensive experience in

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(footnote continued)

Exchange, the Municipal Securities Rulemaking Board and the National Association of Securities Dealers, Inc. *See* Katsoris, *Arbitration* at 283 n.13.

arbitrating securities disputes.[18] The arbitration forums established by the SROs have arbitration counsel assigned to each hearing who are available to assist the arbitrators with questions of a legal nature. Arbitrators may also consent to the submission by parties of legal briefs on issues which they believe require clarification.[19] As a practical matter, however, the *Wilko* Court's concerns regarding the ability of arbitrators to properly construe the federal securities laws are misplaced since the types of securities cases arising under § 10(b) normally involve simple factual disputes. Section 10(b) suits brought by customers of broker-dealers routinely allege that a stockbroker: made various misrepresentations; failed to inform a customer of a relevant fact; "churned" a customer's account[20]; improperly executed a customer's order; or purchased securities which were unsuitable for the customer's investment objectives. Securities arbitrators are often better equipped than a jury to resolve these factual issues given their knowledge of the brokerage industry and the types of problems which commonly arise between customers and their stockbrokers. The instant case is a fairly typical § 10(b) lawsuit between a customer and a broker-dealer which easily could be handled in arbitration. As a practical matter, arbitration agreements are invoked primarily in § 10(b) actions between customers and broker-dealers. Other securities fraud actions such

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[18] In the five-year period from 1980 through 1985, approximately 10,000 arbitration cases were filed with the SROs. *See* Fifth Report of the Securities Industry Conference on Arbitration at 7 (Apr. 1986).

[19] The *Wilko* Court's concerns about the ability of arbitrators to determine the meaning of § 12(2) without judicial instruction do not extend to § 10(b). *See Wilko*, 346 U.S. at 436. Judicial interpretation of § 10(b) and Rule 10b-5 promulgated thereunder has been extensive, and arbitrators need only apply the fully developed law to the facts before them. "When we deal with private actions under [§ 10(b) and] Rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn." *Blue Chip Stamps*, 421 U.S. at 737.

[20] Churning generally occurs when a broker, exercising control over the volume and frequency of the trading in his customer's account, abuses his customer's confidence for personal gain by initiating transactions which are excessive in view of the nature of the account. *Armstrong v. McAlpin*, 699 F.2d 79, 91 (2d Cir. 1983).

as those brought by customers against issuers or underwriters would not normally involve contractual agreements to arbitrate. There are simply no valid public policy reasons requiring the resolution of a typical securities dispute in federal court when parties have contracted to resolve such a claim more expeditiously and with less expense in an arbitral forum.[21]

The doubts expressed by the *Wilko* Court regarding the adequacy of judicial review of arbitration awards are similarly misplaced.[22] Notwithstanding the fact that judicial concerns of this type are an inappropriate consideration when determining the arbitrability of a statutory claim, it is clear that Congress has addressed this issue by providing mechanisms for judicial review of arbitration awards which, although limited, are consistent with the underlying purposes of arbitration. Explicit grounds for vacating arbitration awards are found in the Arbitration Act which provides for vacatur when the decision of the arbitrator is tainted by: (1) corruption, fraud, or undue means; (2) evident partiality or corruption of the arbitrators; (3) misconduct on the part of the arbitrators; or (4) the arbitrator exceeding or improperly executing his powers. 9 U.S.C. § 10.

Furthermore, while an arbitrator's award will not be set aside because of misinterpretation of the law, numerous lower courts

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[21] For a further discussion of the fairness, efficiency and sophistication of securities arbitration as administered by the SROs, *see* the *amici curiae* brief filed by the Securities Industry Association, Inc. For a detailed discussion of an alternative arbitration forum for the resolution of securities disputes, *see* the *amicus curiae* brief filed by the American Arbitration Association. Both briefs were filed on behalf of petitioners.

[22] The concerns expressed by the *Wilko* Court in 1953 about the adequacy of the arbitral process and the competency of arbitrators are invalid today given the forums and procedures which exist for securities arbitration as well as the competency of modern arbitrators. Furthermore, the *Wilko* Court's novel statutory construction of an anti-waiver provision emanated from its mistrust of arbitration rather than from any congressional intent evidenced in the Exchange Act or its legislative history. Accordingly, in addition to granting the relief sought by petitioners by refusing to extend the holding of *Wilko* to claims asserted under § 10(b) of the Exchange Act, this Court should also reject the *Wilko* doctrine and hold that claims asserted under § 12(2) of the Securities Act are arbitrable.

have relied on *dictum* in *Wilko*, and held that an arbitrator's award will not be confirmed if it is demonstrated that the arbitrator acted in "manifest disregard of the law." *See Siegel v. Titan Indus. Corp.*, 779 F.2d 891, 892 (2d Cir. 1985) (citing *Wilko*, 346 U.S. at 436-37); *see also, Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*, 636 F. Supp. 444, 445 (S.D.N.Y. 1986) (manifest disregard of law under Rule 10b-4 required arbitrators' award to be vacated); *Swift Indus., Inc. v. Botany Indus., Inc.*, 466 F.2d 1125, 1130 (3d Cir. 1972); *San Martine Campania de Navegacion v. Saguenay Terminals, Ltd.*, 293 F.2d 796, 801 (9th Cir. 1961).[23] Two additional grounds for vacating an arbitration award have been judicially created. An award will be vacated if: (1) it is contrary to public policy; or (2) it is irrational. *Amoco Overseas Oil Co. v. Astir Navigation Co.*, 490 F.Supp. 32, 37 (S.D.N.Y. 1979); *Botany Indus. v. New York Joint Board*, 375 F.Supp. 485, 490 n.6 (S.D.N.Y.), *vacated on other grounds sub nom., Robb v. New York Joint Board*, 506 F.2d 1246 (2d Cir. 1974).

The congressional intent embodied in the Arbitration Act to limit review of arbitration awards in order to comport with the nature of the arbitral process was a calculated congressional decision which should not be overridden by the judiciary. Moreover, the Arbitration Act reflects a strong congressional policy in favor of reducing congestion in the federal courts. Such congestion is one of the most serious problems facing the federal judiciary today.[24] When parties agree that a claim should be resolved out of court, only explicit congressional intent should override that

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[23] Manifest disregard of the law can be ascertained by judicial review of the pleadings, the transcript of the proceedings, and the documentary evidence submitted at the hearing. Parties to an arbitration can always arrange for the appearance of a stenographer. *See* Rule 612 of the American Stock Exchange, Inc. Arbitration Rules; Rule 624 of the New York Stock Exchange, Inc. Arbitration Rules; Section 37 of the National Association of Securities Dealers, Inc. Code of Arbitration Procedure. Copies of these rules are contained in the supplemental lodging filed by the Securities Industry Association, Inc. in support of the Petition.

[24] Speech by Chief Justice Warren E. Burger to the American Arbitration Association and the Minnesota Bar Association, on August 21, 1985, reported by UPI on the same date; Speech by Chief Justice Warren E. Burger at New York University on November 18, 1982, reported in the Christian Science Monitor on November 24, 1982.

decision and require the expenditure of the time and resources required by a federal lawsuit. In this case, neither congressional intent nor the language of the Exchange Act requires such an expenditure of time and judicial resources.[25]

III. Congress Did Not Intend to Preclude Enforcement of Contractual Agreements to Arbitrate Claims Asserted Under RICO.

Congress enacted RICO principally to combat the "infiltration of legitimate business by organized crime." *United States v. Turkette*, 452 U.S. 576, 591 (1981). Congress provided for criminal penalties of imprisonment, fines, and forfeiture for violation of the provisions of RICO. 18 U.S.C. § 1963. It also provided for standing to bring an action under § 1964(c), 18 U.S.C. §1964, to private parties allegedly injured in business or property, who are further entitled to recover treble-damages by reason of a violation of § 1962.[26] Respondents invoked § 1964(c) to effectuate their RICO claims against petitioners, alleging that petitioners are liable to them under 18 U.S.C. § 1962(c) due to violations of the following predicate RICO activities: mail fraud, 18 U.S.C. § 1341; wire fraud, 18 U.S.C. § 1343; and fraud in the sale of securities in violation of §§ 10(b) and 20 of the Exchange Act, 15 U.S.C. §§ 78j(b), 78t. (R. 9).

This Court has held that a statutory claim will not be exempted from the clear mandate of the Arbitration Act absent congressional intent deducible from the statute or its legislative history. *Mitsubishi*, 105 S.Ct. at 3355. The text of the RICO

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[25] A finding that § 10(b) claims are arbitrable will also eliminate another source of waste – the maintenance of duplicative proceedings in separate forums. As a result of this Court's decision in *Byrd*, federal courts are required to compel arbitration of state law and common-law claims. *See Byrd*, 470 U.S. at 217. If at the same time courts are required to hear federal claims based on the same facts, parallel – and most likely duplicative – proceedings will result with attendant collateral estoppel problems. *Id.*

[26] The text of § 1962, 18 U.S.C. § 1962, is reproduced in its entirety at Appendix A.

statute is devoid of any language which precludes arbitration of civil RICO claims and RICO does not even contain an anti-waiver provision of the type which the *Wilko* Court relied upon in prohibiting arbitration of claims asserted under § 12(2) of the Securities Act. Nothing contained in the legislative history of RICO indicates that Congress intended to prohibit arbitration of civil RICO claims. Quite to the contrary, this Court has noted that Congress paid little attention to the private treble-damages provision contained in § 1964(c):

> Added to the House version of the bill after the original bill had been passed by the Senate, the private treble-damages provision later codified as section 1964(c) received relatively little discussion in either house of Congress.

Mayaja, Inc. v. Bodkin, 803 F.2d 157, 164 (5th Cir. 1986) (citing *Sedima, S.P.R.L. v. Imrex Co.*, 105 S.Ct. 3275, 3280 (1985)). The Third Circuit Court of Appeals has also noted the complete absence of legislative history regarding RICO's arbitrability which led that court to believe that Congress never considered whether arbitration of RICO claims should be prohibited. *Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 797 F.2d 1197, 1202 (3d Cir. 1986). The lack of indication in either RICO or its legislative history that Congress intended to create an exception to the Arbitration Act is sufficient evidence to find that no such exception was intended for civil RICO claims.[27] Congress was certainly aware of the Arbitration Act when it enacted RICO and it presumably would have addressed any conflict between that Act and RICO if it perceived one, either by directly prohibiting

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[27] The majority of the district courts ruling on this issue have followed this analysis. These courts were not bound by prior circuit precedent. At the time the Petition was filed, petitioners were aware of 47 district court decisions ruling on the enforceability of agreements to arbitrate civil RICO claims. Twenty-seven district court decisions held that civil RICO claims are arbitrable, while 19 decisions held that civil RICO claims are nonarbitrable. A complete list of these district court decisions is contained in the Petition at Appendix F. The only court of appeals to rule on the issue at the time the Petition was filed was the Second Circuit in *McMahon*, 788 F.2d at 98-99 (all civil RICO claims nonarbitrable based on public policy). Subsequently,

(footnote continued)

arbitration of civil RICO claims or, if *Wilko's* analysis is followed, by prohibiting waiver of the judicial forum in the form of an anti-waiver provision. Congress did neither and, accordingly, contractual agreements to arbitrate civil RICO claims should be enforced.[28]

A. The Public Policy Rationale Relied on by the Court Of Appeals for Prohibiting Arbitration of RICO Claims is Not Supported by the RICO Statute or Its Legislative History.

Although Congress did not evidence any intention in the RICO statute or its legislative history to prohibit enforcement of agreements to arbitrate RICO claims, the court of appeals nevertheless held that congressional policies underlying the RICO statute render RICO disputes unsuitable for resolution by arbitration. *McMahon*, 788 F.2d at 98-99. This holding was based upon the court's decision in *American Safety* which held antitrust claims nonarbitrable due to public policy considerations.

The analysis of the court of appeals must be rejected if the principles this Court set forth in *Mitsubishi* are to have any meaning at all. The *American Safety* doctrine authorizes a case-by-case judicial review of the purposes behind a particular statute to determine its arbitrability. However, every statute enacted by Congress is obviously a result of a legislative process that

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(footnote continued)

three additional courts of appeals have ruled on the issue, resulting in conflicting holdings among these courts. *Compare Jacobson*, 797 F.2d at 1202-03 (civil RICO claims arbitrable except when predicated on nonarbitrable offenses); *Tashea v. Bache, Halsey, Stuart, Shields, Inc.*, 802 F.2d 1337, 1339 (11th Cir. 1986) (per curiam) (civil RICO claims predicated on violations of the securities laws nonarbitrable); *Mayaja*, 803 F.2d at 162 & n.6 (civil RICO claims arbitrable).

[28] When Congress enacted RICO in 1970 as Title IX of the Organized Crime Control Act, Pub. L. 91-452, 84 Stat. 922, it did not intend to repeal the Arbitration Act by implication. The same argument that applies to petitioners' contention that the Exchange Act did not repeal the Arbitration Act by implication applies to RICO. *See* text at 16-17.

aspires to achieve a purpose, and there can be no doubt that there are strong policies inherent in every federal statute. Courts following *American Safety* can always override the clear congressional intent manifested in the Arbitration Act in favor of their own desire to keep statutory claims in a judicial forum. The Fifth Circuit Court of Appeals recently noted that the Second Circuit Court of Appeals' application of the *American Safety* doctrine to civil RICO claims in *McMahon* was inappropriate:

> We decline to follow *McMahon* because, as the Third Circuit [in *Jacobson*] noted, the *McMahon* court paid too little deference to the Supreme Court's decision in *Mitsubishi*. *McMahon* ignores *Mitsubishi's* instruction that congressional intent governs the analysis of arbitrability of a statutory claim under the Arbitration Act. After *Mitsubishi*, "determining statutory claims to be nonarbitrable on the basis of some judicially recognized public policy rather than as a matter of statutory interpretation is no longer permissible."

Mayaja, 803 F.2d at 163 n.6 (citations omitted).

Even if a public policy analysis of the type conducted by the court of appeals is applied, the policies underlying RICO do not conflict with the Arbitration Act. *American Safety* and *McMahon* reflect a misconception by the court of appeals of the primary congressional purposes underlying the antitrust laws and RICO. In *American Safety*, the court of appeals held that domestic antitrust claims are nonarbitrable because of the fundamental importance to American democratic capitalism of the antitrust laws. The court determined that this factor elevated the private cause of action and its attendant treble-damages feature granted by Congress in the antitrust laws into a right that could only be enforced in a judicial forum. The court held that the plaintiff in an antitrust action becomes a "private attorney-general" who protects the interests of the public at large, and, accordingly, his individual action is subordinate to the broader "public policy" underlying the antitrust laws. *American Safety*, 391 F.2d at 826. The court of appeals concluded that the "public" policy

behind the antitrust laws superseded the congressional policy in the Arbitration Act to enforce "private" agreements to arbitrate disputes.

Having articulated this distinction, the court discussed three additional reasons why it believed Congress must have intended such "public" disputes to be resolved in a judicial forum: (1) the arbitration agreement might be contained in a contract of adhesion; (2) antitrust issues are too factually and legally complex for arbitrators; and (3) arbitrators are generally businessmen who are themselves regulated by the antitrust laws, and therefore should not be determining issues of "public" interest. *Id.* at 827.

In *Mitsubishi*, this Court effectively rejected the *American Safety* doctrine. The Court relied on international aspects of the antitrust dispute involved in *Mitsubishi* to support its holding, but it nonetheless conducted an analysis of *American Safety* which left little doubt of its deficiencies. While the Court did not explicitly overrule *American Safety* in the domestic context, "*Mitsubishi* rejected so much of *American Safety*'s reasoning it is difficult to say what is left of the opinion to rely on." *Mayaja*, 803 F.2d at 163 n.6.[29] Most importantly, this Court examined and rejected the "core" of the *American Safety* doctrine; namely, the reliance by the court of appeals on the "public" deterrent function of the antitrust laws as a basis for prohibiting arbitration of antitrust claims. *American Safety*, 391 F.2d at 826. The Court in *Mitsubishi* analyzed the legislative history of the Clayton Act and the Sherman Act and concluded that although the "policing" function of the antitrust statutes exists, it is merely incidental to the private remedial function of the statutes. *Mitsubishi*, 105 S.Ct. at 3358-59.

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[29] The court of appeals limited the *Mitsubishi* analysis to the international setting involved in *Mitsubishi*, but failed to state why the principles set out in the Court's opinion would not apply equally to a domestic transaction. *McMahon*, 788 F.2d at 98. Both the Fifth and Third Circuit Courts of Appeals followed the *Mitsubishi* analysis and held RICO claims arbitrable in a domestic context in *Mayaja* and *Jacobson*, respectively. All but one of the 27 district court decisions holding RICO claims arbitrable, which are listed in the Petition at Appendix F, involved a domestic setting.

The Court stated:

> Notwithstanding its important incidental policing function, the treble-damages cause of action conferred on private parties by § 4 of the Clayton Act, 15 U.S.C. § 15 . . . seeks primarily to enable an injured competitor to gain compensation for that injury.
>
> . . . .
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> When first enacted in 1890 as § 7 of the Sherman Act, the treble-damages provision "was conceived of primarily as a remedy for [t]he people of the United States as individuals. . . ."

Mitsubishi, 105 S.Ct. at 3359 (citing *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 486 n.10 (1977)). Furthermore, this Court in *Mitsubishi* expressed skepticism about each of *American Safety's* remaining reasons for requiring a judicial forum, concluding that these concerns were unfounded since: (1) arbitral forums are capable of handling complex matters; (2) there is no reason to assume without factual support that the arbitration clauses were contained in unenforceable contracts of adhesion; and, finally, (3) there is no reason to presume that arbitrators, although businessmen, would not be impartial. *See Mitsubishi*, 105 S. Ct. at 3357-58.

Notwithstanding this Court's prior rejection of *American Safety's* emphasis on the "public" nature of the antitrust laws as a basis for prohibiting arbitration of antitrust claims, the court of appeals relied on the identical analysis as a basis for prohibiting arbitration of RICO claims:

> In other contexts, we have recognized the inappropriateness of the United States Arbitration Act when strong public policy considerations are involved. In *American Safety Equipment Corp. v. J. P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968), we stated that "a claim under the antitrust laws is not merely a private matter. The Sherman Act is designed to promote the national interest in a competitive economy; thus, the plaintiff asserting his rights under the Act has been likened to a private attorney-general who protects the

> public's interest." 391 F.2d at 826. We hold that there are comparable concerns inherent in the enforcement of RICO claims.

McMahon, 788 F.2d at 98. The Court concluded:

> Enforcement of the RICO statute is particularly appropriate in a judicial forum because of strong policy concerns, the need for development of the record, and judicial clarification and resulting consistency in resolving disputes under this relatively new statute.

Id. at 98-99.

There is no basis for the strong deference given by the court of appeals to the deterrent function of the RICO statute. While the criminal RICO penalties serve a deterrent function, the legislative history of civil RICO emphasizes the congressional intent to compensate victims of organized crime. For example, Representative Steiger emphasized civil RICO's primary remedial function when he introduced the private treble-damages provision to the House Judiciary Committee:

> Not every businessman, of course, will wish to take advantage of such a remedy, but those who have been wronged by organized crime should at least be given access to a legal remedy. In addition, the availability of such a remedy would enhance the effectiveness of [RICO's] prohibitions.

Hearings on S. 30, and Related Proposals, before Subcommittee No. 5 of the House Committee on the Judiciary, 91st Cong., 2d Sess. 520 (1970). There are repeated references throughout the legislative history of RICO that the treble-damages feature in RICO was based upon the same purpose underlying § 4 of the Clayton Act, which is remedial in nature. *See* 116 Cong. Rec. at 35, 190, 295, 342-47 (1970). As the Fifth Circuit recognized in *Mayaja*:

> The primary purpose of [§ 1964(c)] is to compensate those injured by organized crime; the section's secondary purpose is to deter racketeers from inflicting such injuries.

Mayaja, 803 F.2d at 165.

The doubts expressed by the court of appeals in *McMahon* regarding the adequacy of the arbitral process are identical to those it set forth in *American Safety* which this Court rejected in *Mitsubishi*. 105 S. Ct. at 3354. Moreover, since the underlying fact pattern of an alleged civil RICO violation in a garden-variety securities fraud lawsuit is the same as that supporting violations of the federal securities laws, the arbitral forums established by the SROs and overseen by the Securities and Exchange Commission are well equipped to resolve civil RICO disputes. *See Jacobson*, 797 F.2d at 1203 ("the heart of the [RICO] dispute still will be over whether the securities laws were violated"). "So long as the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function." *Mitsubishi*, 105 S. Ct. at 3359-60.

The decision of the court of appeals is premised upon misconceptions about the congressional policies underlying RICO as well as baseless concerns regarding the ability of arbitrators to enforce these policies. This Court should defer to congressional intent and enforce the agreement of the parties to arbitrate their RICO disputes.

B. Public Policy Considerations are Nevertheless Misplaced Given the Nature of the Civil RICO Claims Presently Being Asserted in the District Courts.

Even if a public policy analysis of the type conducted by the court of appeals in *American Safety* and *McMahon* is appropriate, contractual agreements to arbitrate civil RICO claims should nevertheless be enforced since the vast majority of RICO claims do not impact on the general society or involve vital national interests. Indeed, as this Court recognized in *Sedima*, the majority of civil RICO claims have been asserted against

respected and legitimate enterprises, rather than against members of organized crime. *Sedima*, 105 S. Ct. at 3287; *see also The Supreme Court-Leading Cases*, 99 Harv. L. Rev. 120, 312-13 (1985) (the subject matter of private civil RICO actions is increasingly ordinary commercial fraud).

The underlying lawsuit is indicative of the typical RICO action that burdens the federal court system today, which frames, as a RICO claim, commercial disputes that otherwise would involve only claims of breach of contract, securities law violations, or fraud. *See Haroco, Inc. v. American Nat. Bank and Trust Co.*, 747 F.2d 384, 386-87 (7th Cir. 1984), *aff'd*, 105 S. Ct. 3291 (1985) (per curiam). Respondents allege securities fraud based upon churning and various misrepresentations committed by their former securities broker. Their RICO claims are premised upon the identical fact pattern supporting their fraud claims. This is a classic example of a plaintiff's "Pavlovian inclusion of a RICO claim" in almost every securities lawsuit. *Huss v. Goldman, Sachs & Co.*, 635 F. Supp. 1227, 1228 (N.D. Ill. 1986). As noted in *Huss*, plaintiffs in securities cases routinely assert claims under the federal securities laws, state blue sky laws, and RICO. *Id.* at 1227. This type of racketeering allegation has become the rule rather than the exception as RICO has become "essentially a federal business tort statute." *See, e.g., Brener v. Becker Paribas Inc.*, 628 F. Supp. 442, 450 (S.D.N.Y. 1985); *Bale v. Dean Witter Reynolds, Inc.*, 627 F. Supp. 650, 654 (D. Minn. 1986); *West v. Drexel Burnham Lambert, Inc.*, 623 F. Supp. 26, 28-29 (W.D. Wash. 1985).

A recent survey of trial court decisions conducted by the American Bar Association revealed that 77% of all civil RICO cases reported involved securities fraud or mail or wire fraud in a commercial or business setting.[30] In that same survey, the ABA

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[30] *See* Report of the Ad Hoc Civil RICO Task Force, A.B.A. Section of Corp., Banking & Bus. Law (1985) at 55-56 (hereinafter cited as ABA *Report*); *see also* Abrams, *The Civil RICO Controversy Reaches the Supreme Court*, 13 Hofstra L. Rev. 147, 153 n.31 (1985) ("prior to 1985, 77% of all civil RICO cases at the trial court level involved securities, mail or wire fraud in a commercial setting").

analyzed 270 RICO lawsuits and discovered that broker-dealers were the primary defendants in at least 40 of the cases, banks were the primary defendants in 32 cases, and lawyers and accountants were defendants in over 20 cases. These published judicial decisions clearly demonstrate the burgeoning use of civil RICO against reputable business and professional entities and persons. ABA *Report* at 35 n.41. Another survey of 132 published civil RICO decisions indicates that 63 cases arose out of securities transactions or commodities trading, and another 38 cases arose out of commerical and contractual disputes.[31] As noted in the AICPA *Report*, "cases that could fairly be characterized as having anything to do with aiding the war on organized crime are a tiny minority." AICPA *Report* at 15 (footnote omitted). It is therefore evident that RICO has "evolv[ed] into something quite different from the original conception of its enactors," since it has been utilized for purposes outside congressional intent to combat the infiltration of legitimate business by organized crime. *Sedima*, 105 S. Ct. at 3287.

In light of the universal recognition of the manner in which civil RICO has been misapplied, many of the district courts faced with RICO claims have concluded that such disputes can be resolved by arbitrators with no risk to any perceived public policy concerns. *See, e.g., Steinberg v. The Illinois Co.*, 635 F. Supp. 615, 619-20 (N.D. Ill. 1986); *Sacks v. Dean Witter Reynolds Inc.*, 627 F. Supp. 377, 379-81 (C.D. Cal. 1985); *see also West*, 623 F. Supp. at 29 ("there is no reason to pay lip service to a policy that justifies only a tiny minority of RICO cases"). Indeed, it is highly unlikely that the enforceability of arbitration agreements will *ever* arise in the types of cases that Congress envisioned when it enacted RICO. As one district court noted, a contract between a shopkeeper and an organized crime henchman who approaches him for protection money undoubtedly would not contain an

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[31] *See* American Institute of Certified Public Accountants, "The Authority to Bring Private Treble-Damage Suits Under 'RICO' Should Be Reformed," AICPA, *White Paper On Civil RICO* at 14-15 (July 31, 1985), *reprinted in* Oversight on Civil RICO Suits: Hearings on Oversight on Civil RICO Suits Brought Under 18 U.S.C. 1964(c) Before the Senate Committee on the Judiciary, 99th Cong., 1st Sess. 251 (1985) at 14-15 (hereinafter cited as AICPA *Report*).

agreement to arbitrate. *Ross v. Mathis*, 624 F. Supp. 110, 117 n.6 (N.D. Ga. 1985). Therefore, even if an examination of public policy considerations is part of a proper analysis in deciding whether contractual agreements to arbitrate civil RICO claims are enforceable, the public policy concerns of the court of appeals are meritless since simple commercial disputes do not implicate public policy.

CONCLUSION

Based on all of the foregoing reasons, the judgment of the United States Court of Appeals for the Second Circuit should be reversed insofar as it refused to enforce the contractual agreement of the parties to arbitrate claims asserted under § 10(b) of the Exchange Act and RICO.

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November 19, 1986

Respectfully submitted,

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APPENDIX

APPENDIX A

STATUTORY AND REGULATORY PROVISIONS INVOLVED

United States Arbitration Act

9 U.S.C. § 2:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 3:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

Securities Act of 1933

Section 12(2), 15 U.S.C. § 77 l (2):

> Any person who –
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> * * *
>
> (2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of

said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

Section 14, 15 U.S.C. § 77n:

Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void.

Section 22(a), 15 U.S.C. § 77v(a):

The district courts of the United States, the United States courts of any Territory, and the District Court of the United States for the District of Columbia shall have jurisdiction of offenses and violations under this title and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in

equity and actions at law brought to enforce any liability or duty created by this title. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business or in the district where the offer or sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U.S.C. title 28, secs. 225 and 347). No case arising under this title and brought in any State court of competent jurisdiction shall be removed to any court of the United States. No costs shall be assesed for or against the Commission in any proceeding under this title brought by or against it in the Supreme Court or such other courts.

Securities Exchange Act of 1934

Section 10, 15 U.S.C. § 78j(b):

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 29(a), 15 U.S.C. § 78 cc(a):

> Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

Racketeer Influenced and Corrupt Organizations Act

18 U.S.C. § 1962:

> (a) It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of an unlawful debt in which such person has participated as a principal within the meaning of section 2, title 18, United States Code, to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce. A purchase of securities on the open market for purposes of investment, and without the intention of controlling or participating in the control of the issuer, or of assisting another to do so, shall not be unlawful under this subsection if the securities of the issuer held by the purchaser, the members of his immediate family, and his or their accomplices in any pattern or racketeering activity or the collection of an unlawful debt after such purchase do not amount in the aggregate to one percent of the outstanding securities of any one class, and do not confer, either in law or in fact, the power to elect one or more directors of the issuer.
>
> (b) It shall be unlawful for any person through a pattern of racketeering activity or through collection of an unlawful debt to acquire or maintain, directly or indirectly, any interest in or control of any enterprise

which is engaged in, or the activities of which affect, interstate or foreign commerce.

(c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

(d) It shall be unlawful for any person to conspire to violate any of the provisions of subsections (a), (b), or (c) of this section.

18 U.S.C. § 1964(c):

Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee.

Securities and Exchange Commission Regulation

Rule 10b-5, 17 C.F.R. § 240.10b-5:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.